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William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW
Washington, D.C. 20554

In the Matter of Implementation of Section 3 (n) and 332 of the Communications Act - Regulatory Treatment of Mobile Service - PR Docket No. 94-108

Dear Secretary Caton:

Enclosed please find an original and nine copies of the New York State Public Service Commission's Reply to the Opposition to Extend Rate Regulation.

Sincerely,

Penny Rubin
Assistant Counsel

Enc.

PBR:djn\rubin\caton.fcc

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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Implementation of Sections 3(n)	)	PR Docket No. 94-108
the Communications Act	)	
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Regulatory Treatment of Mobile Services	)	

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REPLY TO OPPOSITION

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REPLY TO OPPOSITION

The New York State Public Service Commission (NYPSC) submits this Reply to comments in opposition to the NYPSC Petition to Extend Rate Regulation of Existing Commercial Mobile Service Providers in New York (NYPSC Petition), pursuant to the Federal Communications Commission's (the Commission) rules for this proceeding.

Introduction and Summary of Position

On August 5, 1994, the NYPSC filed a Petition, pursuant to 47 C.F.R. §20.13, for authority to continue to regulate the rates of Commercial Mobile Radio Service (CMRS) providers operating in New York. The NYPSC seeks to continue its authority to regulate the rates of cellular carriers in New York.[1/] The Petition rests upon the grounds that continued cellular rate regulation provides the necessary

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[1/] By way of clarification, some of the opponents seek to have the Commission declare that New York regulation would not apply to paging, narrow-band PCS, and local SMR systems. Under the New York Public Service Law, New York does not now have authority to regulate one-way paging or two-way mobile telephone service with the exception of services provided by means of cellular radio communication. New York Public Service Law Section 5.3. In the event that PCS or any other technology become telecommunications services under New York Law, the NYPSC will then consider whether to seek regulatory authority.

oversight to ensure that rates continue to remain just and reasonable, and nondiscriminatory. We established that the manner in which we exercise authority to regulate rates in New York serves as a deterrence to anticompetitive and discriminatory practices, and therefore promotes competition in the wireless market.

The opponents claim that New York has not met its burden that "market conditions with respect to CMRS fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory." They claim that Congress intended that the states be preempted; that the evidence relied upon by New York is insufficient; that cellular rates are higher in New York, and other states, because of rate regulation; and that rate regulation will impede competition for wireless services.[2/]

The opposition misreads the legislative history. Congress did not intend that the Commission preempt the states in order to create a uniform nationwide regulatory regime. The underlying purpose for uniformity under the Omnibus Reconciliation Act of 1993 (The Act) is to correct the disparity in regulation of private carriers and common carriers, to the extent they provide the same services.[3/] Moreover, the Commission's decision to forebear from rate regulation of interstate carriers has little bearing on rate regulation of

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[2/] Oppositions of NYNEX Mobile Communications Company (NYNEX), Rochester Tel Cellular Holding Company (Rochester), the Cellular Telecommunications Industry (CTIA), Contel Cellular Inc. (Contel), McCaw Cellular Communications, Inc. (McCaw) and Southwestern Bell Mobile Systems Inc. (Southwestern Bell).

[3/] Omnibus Budget Reconciliation Act of 1993, Pub. L. No.103-66, Title VI.

intrastate services. After all, cellular service is predominantly an intrastate service.

Furthermore, various providers of wireless services as well as the Department of Justice confirm that cellular service is not effectively competitive and that comparable substitutes for cellular service do not exist today. In addition, there is no evidence that regulation of cellular carriers in New York thwarts wireless competition or that continuing light regulation of cellular carriers in New York will impede further development of this market. Finally, the study relied upon to conclude that rate regulation causes higher rates is seriously flawed and does not reflect the state of rate regulation in New York. The Petition should be granted.

I. New York Has Met the Statutory Burden

Under The Act, states may continue to regulate the rates of commercial mobile service providers if they can demonstrate that:

> market conditions with respect to such services fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory[4/]

The NYPSC Petition provides sufficient evidence for the Commission to conclude that continuing rate regulation is necessary to ensure that cellular rates remain just and reasonable and nondiscriminatory.

[4/] The Act, Title VI Section 6002(c).

A. Congress Did Not Intend to Preempt the States

The opponents claim that Congress intended to preempt the state rate regulation as it had done with state entry regulation in order to create a uniform nationwide regulatory regime.[5/]

The legislative history establishes no such clear intent. The underlying purpose for uniformity under The Act is to correct the disparity in regulation of private carriers which act like common carriers, and common carriers. The House Report clarifies that under the existing law:

> private carriers are permitted to offer what are essentially common carrier services, interconnected with a public switched telephone network, while retaining "private" carrier status. Functionally, these private carriers have become indistinguishable from common carriers but private land mobile carriers and common carriers are subject to inconsistent regulatory schemes.[6/]

The Committee made a specific finding that "continued growth and development of the disparities in the current regulatory scheme could impede the continued growth and development of commercial mobile services and deny consumers the protection they need if new services such as PCS were classified as private."[7/] Thus, the notion of a uniform regulatory approach was aimed at the disparity between regulated common carriers and private carriers who provide common carrier services free of common carrier regulation, not at continuing state regulation. The House also specifically recognized that this

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[5/] CTIA at 2-5; Contel at 3; Rochester at 2; and NYNEX at 3-5.

[6/] H.R. Report No. 111, 103rd Congress, at 259-260 (House Report).

[7/] House Report at 260.

disparity failed to protect consumers through the absence of common carrier regulation for those classified as private.

Furthermore, Congress recognized that its desire for regulatory uniformity among carriers must be tempered by actual market conditions. Congress recognized that flexibility is necessary to take into account actual market conditions.[8/]

Just as Congress recognized that the Commission may continue to regulate commercial mobile services, depending on market conditions, it also chose to allow the states to regulate them, based upon the conditions in a particular state.

To bolster its claim for intrastate and interstate uniformity, Contel (at 5) relies on Conference Report language which states:

> it is the intent of the Conferees that the Commission, in considering the scope, duration or limitation of any State regulation shall ensure that such regulation is consistent with the overall intent of this subsection as implemented by the Commission, so that, consistent with the public interest, similar services are accorded similar regulatory treatment. . . (at 26)

Despite Contel's claim, this provision is not aimed at state/federal uniformity. Instead, it directs the Commission to ensure that any limitations imposed by state regulators not exacerbate the disparity of regulatory treatment between private carriers and common carriers. Had Congress intended to require nationwide uniform treatment of cellular carriers, it would not have provided the states the option to seek approval for continued rate regulation. Instead, it could have instructed the Commission to preempt state rate

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[8/] House Conference Report No. 103-213, at 491 (Conference Report).

regulation if the Commission opted to it would forebear from federal rate regulation. It did not do this. Rather, it acknowledged that market conditions in different states may require different approaches.

B. The Commission's Decision to Forebear from Rate Regulation of Interstate Cellular Service Does Not Justify Preemption of State Regulation

According to Contel, because the Commission decided to forebear from rate regulation, New York's Petition therefore assumes a violation of the Communications Act (Contel at 11). McCaw takes essentially the same position (at 6).

This argument confuses the Commission's jurisdictional reach. The Commission's decision to forebear from rate regulation is a decision to forebear from interstate rate regulation, pursuant to Title II of the Communications Act. Its decision and analysis of the interstate market has absolutely no bearing on the conditions and circumstances with respect to the intrastate market in New York.[9/] To conclude otherwise is to extend the reach of the Commission beyond Title II to intrastate matters, still reserved for the states under Section 152(b) of the Communications Act.

Moreover, McCaw, Contel and others fail to recognize that if the Commission preempts state rate regulation, intrastate ratepayers will have virtually no remedies available to them despite their view that local consumers can seek redress from the Commission. It is highly improbable that the Commission will have the resources or the staff to adequately deal with those complaints about local service.

[9/] Since cellular service is predominantly an intrastate service, it is not surprising that the Commission's findings may be different from those of the states.

C. The Cellular Market Today is Not Fully Competitive

The opponents claim that regulation is unnecessary because the wireless industry is sufficiently competitive. In defending their position, they point to an increase in the number of providers, significant growth in network capacity and in the number of subscribers, the declining price of cellular service, and continuing cellular infrastructure investment.[10/]

There is no question that there has been tremendous growth in the cellular industry in the last 7 to 8 years. In fact, as Southwestern Bell points out, "forward looking and light regulation by New York has not precluded the development of commercial mobile (cellular) service in the state" (p.1)[11/].

However, underlying New York's Petition for continuing rate authority is the concern that with only two competitors assigned spectrum in each MSA cellular carriers still have substantial market power. Until very recently, spectrum scarcity and technical limitations have presented absolute barriers to entry which preserved the existing cellular carriers' market dominance. As CTIA states, "[c]ommercial mobile services are the fastest growing segment of the telecommunications industry with no single provider capable of fully meeting consumer demand" (CTIA at 10). With this rapid growth in demand, coupled with significant barriers to entry which have not yet been eliminated, premature deregulation before fully effective competition is in place may lead to entrenched dominance, or could

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[10/] McCaw at 17-18; NYNEX at 6-7; Southwestern Bell at 6-7.

[11/] Southwestern Bell's claim that continuing New York regulation will thwart competition in the future, (p.1) contradicts its view that New York regulation has not hurt the industry in the past.

result in one carrier merely following the lead of the second carrier.[12/]

The Justice Department has reached the very same conclusion about the competitiveness of the cellular market (July, 25, 1994, Memorandum of the United States In Response To The Bell Companies' Motions For Generic Wireless Waivers (DOJ Memo in Response) (Exhibit 1[13/]). According to the Justice Department, "this view is shared by the Federal Communications Commission (FCC) which concluded on four separate occasions in the last three years that cellular systems have substantial market power, and by the General Accounting Office" (DOJ Memo in Response p. 14).

According to the DOJ Memo in Response, Bell Operating Companies (BOCs) were telling the Justice Department that cellular is "robustly competitive," yet at the same time, in their own internal documents they demonstrate that cellular is comfortably noncompetitive.

The DOJ Memo in Response provides the following industry view of the market:

> Southwestern, which argues that "wireless markets today are vigorously competitive" (SOB Mem. 11), observed in 1991 -- the year it and the other BOCs filed for this waiver -- that there was an "absence of significant price competition" in cellular, and

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[12/] See, Shepard, William G., "Regulation and Efficiency: A Reappraisal of Research and Policies", National Regulatory Research Institute, July 1992.

[13/] United States of America v. Western Electric Company, Inc. and American Telephone and Telegraph Company, Civic Action No. 82-0192 HAG.

> that the market is "highly attractive" for that reason (Exh.1, p.15).[14/]

Moreover, according to the DOJ Memo In Response, Southwestern further observed:

> The FCC predicted sufficient levels of rivalry from a duopoly. In actuality, the two players in each market have been able to avoid serious competition in this rapid growth environment (Exh.1, p.15).

The DOJ states that:

> More recently, Southwestern observed that "new industry entrants will not be *effective* competition before 1996" (emphasis in original). Southwestern assessed that threat of new entrants as "medium," and the bargaining power of buyers as "low" -- recognizing that the "threat of substitute products or services [is] low" and that "extensive time periods for regulatory determinations, license awards and infrastructure construction will occur prior to the emergence of effective competitors" (Exh.1, p.15-16).

It demonstrates that other BOCs have made similar observations about cellular markets:

> The duopoly structure is a continuation of the status quo ... Under this scenario, competitive intensity is greatly reduced. This enables direct cellular competitors to improve margins ... In fact, the most significant element of this structure is the probability that profit margins for all competitors would tend to increase under prolonged restricted competition (Ameritech July 1990)(Exh.1, p.16).

It relies on a Bell Atlantic Response:

> The burgeoning demand for cellular service when coupled with the duopolistic market structure mandated by the FCC has led most investment analysts to conclude that the cellular industry will be even more profitable than cable TV, to which comparisons are constantly made ... While

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[14/] According to DOJ, in June 1992, six months after filing the waiver application asserting that cellular was "robustly competitive," US West observed: "Current duopoly structure and market growth limits competitive intensity."(Exh.1, p.16)

> BAMS believe that providing quality cellular service requires considerably more investment in the infrastructure of the business ... than does cable, it must be acknowledged that the investment community has been generally correct in forecasts of thriving cellular revenues. It is also important to note that increased market penetration in the absence of downward price pressures will buy a lot of infrastructure (Exh.1, p.16).

Further, the Department of Justice concludes that cellular carriers have the ability to raise prices for cellular service, by raising prices in a manner that is less visible to the customer and provides an example of such action, (Exhibit 1, p. 16-19.[15/]).

RTC argues that Congress considered and rejected New York's concern about the duopolistic nature of the market.[16/] According to Rochester, "when Congress enacted The Act it obviously knew that only two licenses per market were allocated spectrum to provide cellular service. Nonetheless it preempted state rate regulation of cellular service." Rochester at 4.

First, Congress did not preempt state regulation of cellular service. It provided for continuing rate regulation of cellular

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[15/] Attached, as Exhibit 2, are those portions of the Justice Department's filing in the Response to the Motion, dated August 1, 1994, which include internal BOC documents on their views regarding the competitiveness of the cellular market.

[16/] Rochester's reliance on Chillicothe Sand & Gravel Co. v. Martin Marietta Corp., 615 F.2d 427 (7th Cir 1980), (Rochester at 4,fn. 14), as authority for the proposition that antitrust courts have long recognized that a two-participant market can be fully competitive is not borne out by the facts or holding of that case. In fact, Chillicothe concerned a peculiar and specific kind of local market: the sand and gravel market in which, due to transportation costs, "producers are able to compete effectively only in a limited area around their sources." id. at 429. Nor was duopoly an issue in that case, which hinged upon whether or not Martin Marietta engaged in predatory pricing.

service based on state petitions, until such time as the Commission made a finding about the local conditions. If Congress accepted that a duopolistic market does not create serious cause for concern, it would not have permitted the states to continue to rate regulate cellular carriers. Moreover, if Congress had intended the Commission preempt the states if the Commission determined that the duopoly market sufficiently competitive, it could have tied preemption to the Commission's decision to forbear from interstate rate regulation. It did no such thing. The Rochester argument should be rejected.

D. There are no Reasonable Substitutes for Cellular Service

The opponents argue that there are viable substitutes for cellular service. They point to advanced and wide area paging, specialized mobile radio (SMR) and enhanced specialized radio (ESMR), PCS, and wireless cable as alternatives to cellular service (CTIA at 16-19; Contel Exhibit A at 8-12).

These claims overstate the market as it currently exists. At some time in the future these technologies may be used to compete for cellular customers, but as yet there are no SMR, ESMR or PCS providers of wireless telephone offering services with capabilities fully comparable to those generally provided by cellular carriers today in New York. According to the Justice Department, it still remains unclear just when and to what extent these new providers will have an effect on cellular telephone service (DOJ Memo in Response at 25).[17/]

[17/] Exhibit 3 contains the relevant pages from the DOJ's Motion in Response on the status of PCS and SMR deployment.

The Department of Justice concludes that until PCS licenses are assigned and the necessary financing and approvals are in place, it is impossible to determine what services will be provided. According to DOJ, "Bell South itself told the FCC that cellular systems and new PCS licenses will be competitors only to a very limited degree." DOJ Motion in Response at 25.[18/] The DOJ states it is impossible to say how long it will take to develop PCS but it appears that it will be some time before PCS service will have any impact on competition for wireless telephony. "Any assertion that PCS has changed the competitive environment is premature at best." DOJ Motion in Response, pp. 24-25.

Regarding Specialized Mobile Radio, while spectrum has been allocated, it remains unclear whether it will be a true substitute for cellular service. SMR providers offer a dispatch service that is very different from voice grade telephony service provided by cellular carriers. According to Nextel Communications, Inc., the only firm that has begun construction of an SMR system that would provide cellular-like telephone service, "it will face a number of difficulties including having substantially less radio spectrum than that allocated to cellular telephone subscribers, a limited number of equipment suppliers and a current inability to offer nationwide service." Nextel also indicates that its service might not have adequate voice service quality (Nextel's Securities and Exchange

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[18/] While the Commission has announced its intention to conduct PCS auctions at the end of 1994, any estimate of how long it will take a new competitor to obtain financing, obtain government approvals to construct facilities, and to begin marketing these new products is speculative at best.

Commission February 8, 1994 filing as reported in the DOJ Memo in Response at 24-26).

In summary, despite any claims to the contrary, SMR and PCS are only beginning to be developed as substitutes for voice grade cellular telephony service and, to the extent they do become viable substitutes, the timing of their introduction is highly speculative.

E. Market Conditions Justify Continued Regulation

The opponents contend that New York's evidence regarding the cellular market is insufficient to meet its burden. They claim carrier returns of common equity are not particularly meaningful; that market share data does not support that absence of vigorous competition; and that the small number of consumer complaints is directly traceable to successful competition (Southwestern Bell at 12-13, Contel at 14-17).

These arguments should be rejected. Not only is the market still made up of only two participants with significant entry barriers at least for the next few years, but in addition, there is evidence that cellular rates, although declining, appear to be high; that returns on equity are higher than comparable high tech and local exchange company returns; and that market share data suggests that one company has a dominant position in most of the large MSAs. All of this evidence, considered in toto, requires the Commission to conclude that the market in New York, absent regulatory oversight, will fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory.

1. Return on Common Equity

Contel and Rochester seem to confuse the purpose for comparing returns on common equity with rate of return regulation (Contel at 23; Rochester at 7).[19] As Rochester correctly points out, the NYPSC has never subjected cellular carriers to traditional cost-of-service regulation (Rochester at 7). This petition is not about continuing cost-of-service regulation in New York, but is about identifying patterns to suggest that rates may become unjust and unreasonable or discriminatory absent continued light regulation.

Comparisons of returns on common equity are one factor in this analysis. Cellular earnings are higher than unregulated high tech and regulated landline company returns which could suggest that cellular carriers could exercise excessive market power, absent regulatory oversight[20] (NYPSC Petition 8-9).

2. Market Share Data

While a 20% market share may be enough for a competitor to be successful in the telecommunications market, (Southwestern Bell at 12), the purpose of market share is to ascertain patterns within a market.

There is no question that there is some evidence of market concentration in three out of the five major MSAs (NYPSC Petition at 9). While not dispositive, these results suggest caution.

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[19] Contel also misstates that New York is seeking authority to continue to regulate cellular entry and rate regulation (p.12). The Act prohibits state entry regulation.

[20] Southwestern Bell suggests that a comparison of return on common equity is misleading because of the debt to equity ratio of each individual company (at 11). While the debt to equity ratio is very significant, investors rely heavily on comparisons of return on equity in making their decisions.

3. Consumer Complaints and Anticompetitive Practices

Rochester (at 8), Southwestern Bell (at 12), and Contel (at 21) attach no value to the increase the number of consumer complaints. And, Southwestern Bell attempts to discredit New York's concern about anticompetitive behavior by claiming that the NYPSC may have exceeded its jurisdiction (at 13).

There is evidence that consumer complaints are increasing by close to 100% (NYSPC Petition at 9-10). Moreover, it is understandable that the complaint level is relatively low, given the presence of regulatory oversight.[21/]

Regarding the roaming dispute, recently a New York court failed to rule that the NYPSC had exceeded its jurisdiction.[22/]

4. Cellular Rates

The arguments that cellular rates have come down and therefore are reasonable simply state the obvious (Contel at 22; Southwestern at 9). It is the very presence of regulation which deters rates from being unjust and unreasonable. The opponents present no new facts to rebut New York's finding on rates, market share, return on equity, and the meaning of consumer complaint levels. It is these trends, coupled with the fact there are only two providers in a market and no viable substitute currently available, which lead to the conclusion that market conditions fail to protect subscribers adequately from unjust or unreasonable rates or rates that are unjustly or unreasonably discriminatory.

[21/] The fiasco in the Cable TV industry confirms that public outrage can result in a return to regulation with a vengeance.

[22/] Genesee Telephone Company v. PSC and DicommCellular, L.P., __ Misc 2d _____, (Sup. Ct., Albany Co. [Ceresia, Jr, JP]) Index No. 6321-93.

II. New York Regulation is Not An Impediment to Competition

Various opponents argue that New York rate regulation is an impediment to competition (NYNEX at 14, Contel at 23; RTC at 9-10).[23/] They point to our failure to provide a detailed description of the existing or proposed rules we would require if Commission were to grant the petition and that the introduction of new regulation will dampen existing level of competition (NYNEX at 3; CTIA at 14). Finally, they rely on a CTIA study for the proposition that cellular rates are higher in markets where rates are regulated by five to fifteen percent, including New York, because of the existence of rate regulation (NYNEX at 11; and CTIA at 11; and Contel at 21).

A. Cellular Carriers are Lightly Regulated in New York

Despite statements to the contrary, New York is not proposing to create new rate regulations, it is only proposing to enforce its existing regulations, which, as we said in our petition, are contained in 16 NYCRR Section 630.14. Attached as Exhibit 4 are New York's regulations which apply to the construction and filing of tariffs. Except for Section 630.14, these requirements do not affect entry or rate regulation.

The NYPSC has permitted carriers to file tariffs which establish a range of rates (maximum and minimum rates). Consequently, any changes to the rates within the range may be made on one day's notice. Only if a carrier proposes to increase the rates by more than

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[23/] At the same time these parties view regulation as an impediment, they point out that the wireless market is developing and that customers have a wide range of choices including "wireless broadband, digital voice, data and video, cellular, paging ... (NYNEX at 15) If regulation is truly an impediment, these "competitive" services would not have developed.

2 1/2 percent or $100,000, whichever is greater, is an evidentiary hearing required. New York Public Service Law §92.2. There have been very few instances in which cellular rate requests have resulted in hearings. To the extent that new services are introduced, they are acted upon, in most instances within 30 days. (NYPSC Petition at 6).

As those who do business in New York point out, the New York Commission does not require carriers to file cost information to support tariff rate changes (RTC at 7). Contel's claim that rate of return regulation is not valued in the presence of competition is completely consistent with the approach taken in New York. We do not set rates based on costs for cellular carriers or regulate their returns.

New York's simplified regulatory approach is aimed at protecting consumers from anticompetitive and discriminatory practices, should the need arise. Assuming that the cellular market is as competitive as the opposition claims, then it is clear that New York regulation has in no way stifled competitive innovation and creativity, and there is no reason it will be harmful in the future.[24/]

Moreover, there is no basis for the claims by RTC and NYNEX that competition is inhibited because cellular carriers must file their rates, thereby giving competitors advance notice (RTC at 9, NYNEX at 15). The inroads made in long distance suggest that AT&T's notice requirements have not hurt long distance competition. In fact,

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[24/] As Contel and others point out (Contel at 15), the NYPSC in a 1989 Opinion concluded that cellular service is provided competitively. However, the NYPSC never proposed that the cellular industry be deregulated. It proposed, instead, that the PSC be given flexibility to regulate based upon local conditions.

the very short notice (usually one day) does nothing to hurt competition because pricing plans, by definition, must be marketed to be successful, and one need only pick up the newspaper or the telephone to learn of a competitors' pricing plans. That Nextel may have on day's lead on NYNEX's plans is no basis for concluding that rate regulation is anticompetitive.[25/]

B. The CTIA Study is Seriously Flawed

CTIA presents an affidavit of Professor Jerry A. Hausman based on a study in which he claims that cellular rates in MSAs that are subject to rate regulation are approximately five to fifteen percent higher than rates in MSAs where there is no rate regulation (CTIA at 11, Hausman Affidavit). The underlying assumptions used in the study are inaccurate. Moreover, the study fails to take into account significant variables that could also affect the price of cellular service. The Commission should not place any weight on its conclusions.

First, the models use inaccurate data. The study incorrectly states the prices for cellular service in New York and seems to incorrectly suggest that New York sets prices based on csot for cellular carriers; second, the two basic regression models are not

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[25/] Rochester's citation of United States v. Container Corp., 393 U.S. 333 (1969) to support its argument that a government filing requirement constitutes collusive price-signalling has no basis. That case concerned a tacit, informal exchange of information among 90% of the corrugated cardboard manufacturers in the Southeast about recent sales prices. The Court held that this agreement constituted an illegal combination, whose effect was to prevent price reduction. In sharp contrast, in a far more comparable case, the U.S. Court of Appeals for the District of Columbia Circuit upheld a Federal Power Commission regulation requiring reporting of utility prices, holding that this "disclosure posed no substantial risks of anticompetitive behavior." Alabama Power Co. v. Federal Power Commission, 511 F.2d 383, 391 (D.C. Cir. 1974).

properly specified and suffer from simultaneity problems. Moreover, even if it were found that rates in the New York MSA were higher than in other MSAs, there are significant factors that affect both price and penetration that have largely been ignored. To suggest that price regulation of cellular service harms consumers in New York based on the evidence presented in this study is clearly unwarranted. Attached as Exhibit 5 is the Affidavit of Dr. Joel P. Brainard, Chief of Regulatory Research in the Office of Regulatory Economics, Department of Public Service. Dr. Brainard describes in detail the errors in the study relied upon by CTIA and others.

1. The Underlying Assumptions Are Inaccurate

a. New York Does Not Price Regulate Based on Cost

The CTIA study rests on the premise that New York sets the price of cellular service based on cost and therefore CTIA suggests that New York regulation causes higher prices (CTIA at 11). As described above, New York does not review rate levels proposed by cellular carriers until and unless a complaint is lodged. Carrier rates are based on what each carrier believes the market will bear.

b. The New York Price Estimate Is Wrong

According to Professor Hausman, in the New York MSA, the average cellular price for 160 minutes of usage for the least expensive rate plan is $110.77 (Hausman Affidavit at 4). This appears to be incorrect. Our studies show that, based on the revenues generated in the New York MSA for 1993, customers are paying over 25% less than Professor Hausman indicates.[26/] This amount reflects the rates for all customers, not just those on the "least expensive

[26/] A reasonable price estimate for 1994 would be even lower because cellular rates are declining.

plan" (Hausman Affidavit at 4).[27] Therefore, estimating prices based on the "least expensive plan" could result in an even lower estimate of average prices.

And, if the Hausman study of the other MSA were error free, the rates in the New York MSA fall well within the same range as those in "unregulated markets."[28]

2. The CTIA Study Ignores Significant Variables

a. The Study Does Not Include Significant Cost Variables

Not only has the study incorrectly reported the prices in New York and the type of New York rate regulation, errors that by themselves discredit the validity of the study, but it also ignores significant variables which affect prices. For a study to meaningfully explain the level of prices in a particular locale, it must include all the significant variables. Yet this study does not take into account variables which affect costs including labor costs, tax rates, the cost of acquiring cell sites and the cost of investing in new technology associated with making better use of the limited spectrum in densely populated areas and other scale effects.[29] Instead, the study incorporates factors affecting demand including

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[27] Due to the current confidential treatment accorded the underlying data, the NYPSC is reluctant to provide that information unless it is critical for the resolution of this proceeding (NYPSC Petition at 7).

[28] There is no reason, however, to believe that the price data used for other MSAs is any more reliable. Indeed, it is reasonable to conclude that the general procedures he has followed also result in incorrect prices in other MSAs (see Exhibit 5).

[29] It is ironic that those in opposition to the NYPSC Petition who contend that cellular services are significantly competitive would rely on a study in which costs appear to play no role in determining price.

population, average commuting time and average income (Hausman Affidavit at 5 ¶12). These and regulation were the only explanatory variables included for the model described in Appendix 1 of the Hausman Affidavit. As underlying costs should be a significant determinant of price, failure to include cost variables in the study vitiates its conclusions.[30/]

b. New York Rate Regulation Does Not Cause Competitors to Raise Prices

The study claims that the filing of rates causes higher rates because competitors have advance notice of a competitor's prices (Hausman Affidavit at 7, ¶17). As described above, the average rate change goes into effect on one day's notice.[31/] Therefore, it is unlikely that in such a short period, a competitor would completely revise a pricing strategy based on this amount of "advance notice." This claim is especially misplaced because if the market is as competitive as claimed, prior notice of rates should cause prices to go down, to the benefit of consumers, and not up. In any event, competitors are more than able to determine pricing arrangements of others merely by calling the other carrier or by reading the newspapers.

[30/] The model also has other serious shortcomings. For example, it fails to recognize that high prices may, in fact, lead to price regulation. The claims that regulation causes higher prices in this context is analogous to the contention that police cause accidents because they are observed at the scene of the accident.

[31/] New York does not prohibit "company specific" rates that are not discriminatory nor do we restrict the use of multi-year contracts (Affidavit at 7, ¶17).

3. Price Regulation Is Not Responsible for Lower Penetration Rates

The study claims that regulation causes lower penetration rates (Hausman Affidavit at 8-9, ¶ 20-21).[32/] Because the underlying assumptions are invalid, this conclusion for New York is meaningless.[33/] As previously identified, rates in New York are substantially lower than claimed in the study; prices used in the analysis are calculated using a procedure that may give misleading results for other MSAs; and New York does not set the prices based on price for cellular services.

Furthermore, there are a number of other reasons penetration rates may be lower in the New York MSA than in the other MSAs listed in the Hausman Affidavit in Table 2 (at 9). For instance, the coin-operated telephone business is flourishing in New York City and while these phones may not be a reasonable substitute for cellular phones in terms of convenience, they do provide a means of communications for the traveler. Moreover there is some question about the effectiveness of cellular phones being used underground. In an area such as New York where tunnels and underground mass transportation are common, this technical constraint may be significant. It is curious that while the cellular industry argues that there are substitutes, its main proponent, a witness for CTIA, fails to include any of those substitutes, including payphones, in the model explaining demand.

[32/] Moreover, because we have no way of verifying the accuracy of this claim, given the other flaws in the study, it is entirely possible that the penetration rate is also incorrect.

[33/] Regarding the findings on elasticity, (Affidavit at 10-11, ¶¶23-24) because the initial premise regarding New York rates are incorrect, because the variables are very limited and the models have other deficiencies (Exhibit 5), the estimates of elasticity are questionable, at best.